

VZCZCXRO4264
RR RUEHAG RUEHDF RUEHIK RUEHLZ
DE RUEHFR #3464/01 1431238
ZNR UUUUU ZZH
R 231238Z MAY 06
FM AMEMBASSY PARIS
TO RUEHC/SECSTATE WASHDC 7706
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/USDOC WASHDC
RUCNMEM/EU MEMBER STATES

UNCLAS SECTION 01 OF 02 PARIS 003464

SIPDIS

SIPDIS

PASS FEDERAL RESERVE
PASS CEA
STATE FOR EB and EUR/WE
TREASURY FOR DO/IM
TREASURY ALSO FOR DO/IMB AND DO/E WDINKELACKER
USDOC FOR 4212/MAC/EUR/OEURA

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [PGOV](#) [FR](#)

SUBJECT: FRENCH GDP GROWTH ON A 2 PERCENT TREND

1. SUMMARY. Annualized French GDP growth of 2.0% in Q-1 shows stable but hardly dynamic improvement. The government is sticking to its GDP forecast range of 2.0-2.5% in 2006, accompanied by a decrease in the unemployment rate to 9% by the end of 2006. However, preliminary employment data showed poor job creation in Q-1. The government said that 2006 privatization proceeds would be used to reduce public debt to 64.6% of GDP. END SUMMARY

GDP Growth Rebounds in Q-1

2. Based on the National Statistical Agency (INSEE) flash estimate, GDP (seasonally and workday adjusted) increased 2.0% (annualized) in Q-1 compared with 1.2% in Q-4 2005. GDP growth accelerated mainly due to a significant 3.6% increase (annualized) in household consumption and a rebound in exports that increased 9.0% compared with Q-4 2005. The increase in exports was essentially due to the global economic recovery, but also to improved price-competitiveness (largely before the dollar began its fall against the euro). Lower growth in imports also contributed to GDP growth. Corporate investment and inventories detracted from GDP growth.

3. The Q-1 growth rate is lower than the forecast of most local economists and the Bank of France. The Bank of France forecast GDP to increase 2.8% (annualized) in Q-1, and economists 2.4%.

Government Shows Optimism

4. Finance Minister Thierry Breton confirmed that the government was sticking to its 2.0-2.5% GDP growth forecast for 2006, saying GDP growth might have been as high 2.8% (annualized) in Q-1 - INSEE may revise its GDP data later. Prime Minister Dominique de Villepin told Parliament on May 16 that GDP growth "would exceed 2%" in 2006. Q The government predicted the unemployment rate would decrease to 9% by the end of the year, down from 9.5% in March 2006, even though job creation in the non-farm private sector (in companies with more than 10 employees) increased a mere 0.1% (20,000 jobs) in Q-1. Despite the increase in oil prices, Breton said he did not foresee any significant "effect on the inflation rate." Breton welcomed the "clear recovery" in exports since the summer of 2005. The current account deficit narrowed significantly in March compared to January and February. For the first quarter, however, the total current account deficit (seasonally adjusted) widened to 8.82 billion euros compared with 5.3 billion euros in Q-1 2005.

Good Performance in Q-2; but Risks Remain

5. Industrial surveys, including the investment survey, indicate that GDP growth could accelerate in Q-2. Risks remain the same, since the strong euro could undermine French exports, and further increase in oil prices could be harmful to consumption and corporate investment. French Central Bank Governor Christian Noyer said that the French economy would probably weather these risks, indicating "we don't see signs of slowdown at this moment. However, we need to remain extremely vigilant and act in an appropriate way if needed."

Finance Minister: Debt Decreasing by the end of 2006

6. In his May 19 conference, Breton said that the privatization of highways, plus the sale of government stakes in Alstom and Aeroports de Paris (the airports authority/operator), would bring in 12 billion euros in proceeds that will be used to reduce the public debt. He committed to reduce the public debt to 64.6% of GDP by the end of 2006.

OppositQ Criticizes Government

7. Socialist politicians criticized government "self-satisfaction", highlighting that INSEE revised downward Q-4 GDP growth to 1.2%, and 2005 GDP growth to 1.2%. They underlined that Q-1 GDP was lower than forecast by economists, notably due to the decrease in corporate investment. Socialist party general secretary Francois Hollande asked: "how sincerely can the government claim that our economy and public finances are improving? The public debt as a percent of GDP increased by more than 8% of GDP in four years, and budget deficits will increase further." The 2006 central government budget is based on the 2.0-2.5% GDP growth.

Comment

8. The Q-1 GDP growth is relatively good news, even if it is lower than expected. Its Achilles' heel for the long term is the weakness of corporate investment. In the short term (e.g., through next year's elections), politicians will find it hard to turn the economy into a campaign issue if France maintains its slow but steady pace.

PARIS 00003464 002 OF 002

On the other hand, the government continues to be overly optimistic about unemployment. Perhaps most worrisome for Breton, preliminary data for investment and employment indicate that economic growth may not be sufficient to reduce the budget deficit without more cuts in spending.

